

Portfolio Commentary

Q4 Market Update

U.S. stocks traded higher during Q4, reflecting softening inflation data and a slowdown in the pace of interest rate increases from the Federal Reserve. For the quarter, the broader market, as measured by the Russell 3000 Index, rose 7.2%. Q4 started strong following reports that broader inflationary pressures were beginning to moderate. Shares reversed course in December as more hawkish commentary from the Fed led to falling prices. Fear of a pending recession remains high and the yield curve remained inverted at the end of the quarter. Stocks traded higher across the market cap spectrum led by strength in Mid Cap companies. Stylistically, Value had one of its strongest quarters of relative performance versus Growth since the popping of the Tech Bubble. Cyclical sectors generally had the edge over Defensive. In terms of market factors that drove performance, Value (lower valuation) and Yield (higher) had a positive impact on relative returns. Volatility factors presented headwinds, while Growth, Quality, and Momentum factors had a mixed impact.

Key Performance Takeaways

The London Company Mid Cap portfolio returned 6.2% gross (6.1% net) during the quarter vs. a 9.2% increase in the Russell Midcap. Stock selection, sector exposure & a temporarily elevated cash balance were headwinds to performance.

The Mid Cap portfolio trailed the benchmark in Q4 and fell short of our upside capture expectations of 85-90%. The portfolio struggled to keep pace with the robust return of the market. Weakness in several larger holdings plus our elevated cash position were drags on performance. The cash proceeds from the acquisitions of two holdings (Alleghany & Citrix) arrived in Q4. This temporary increase in our cash exposure was a headwind in a strong up-market. Looking ahead, we believe the strong cash flow generation and capital flexibility of our businesses should provide meaningful protection if market fundamentals continue to deteriorate.

Top 3 Contributors to Relative Performance

AerCap (AER) – AER continues to execute extremely well in the current environment. Now that AER has achieved their leverage target following the loss of their Russian assets, they are looking to resume share buybacks. Given the favorable demand environment for commercial aircrafts as well as AER's strong market position, we believe it should generate improving rates of return on incremental capital deployed.

Otis Worldwide (OTIS) – OTIS outperformed after reporting quarterly earnings that bested its peers and the overall industry, despite worsening market conditions in China. OTIS continues to capture share and improve productivity while making progress on reducing their effective tax rate. We are attracted to OTIS's market position, strategy, and management's ability to execute.

Past performance should not be taken as a guarantee of future results.

Lamb Weston (LW) – LW continues to benefit from the recovery in overall French fry demand, higher attachment rates, and better than expected pricing. Recent price increases from LW are up double digits, which have offset the higher costs per pound. LW has performed well by focusing on pricing and operational improvements with cost mitigation, reducing SKUs, and streamlining operations. This is a consolidated industry, and the long-term outlook remains very favorable. We remain attracted to LW's market share, pricing power, and industry tailwinds.

Top 3 Detractors from Relative Performance

Entegris (ENTG) – ENTG underperformed during Q4 after reporting lower than expected sales and reducing guidance. There are industry-wide concerns about economic weakness negatively affecting sales, but demand in leading-edge nodes and high-performance computing continues to be favorable. ENTG is a unit-driven business, and the competitive position of the core businesses has not eroded. ENTG has drastically increased its size and scale to become one of the most diversified players in the semi-materials industry. We remain attracted to the industry's high barriers to entry, limited competitors, and high switching costs.

M&T Bank (MTB) – MTB underperformed in Q4 as the company missed expectations in its latest quarter and lowered guidance. While bank earnings can be noisy quarter-to-quarter, subject to macro factors outside the bank's control, we view MTB as one of the higher quality banks. Nothing in the recent results has altered this perspective. MTB continues to put more excess cash to work after being conservative through a very low rate environment, and capital return is attractive. MTB is buying back stock at a pace of ~\$600mm/quarter and pays a dividend yield >3%.

Armstrong World Industries (AWI) – AWI underperformed the broader market during Q4, reflecting project delays and macro related uncertainty. While company earnings are sensitive to changes in the economy, we note that roughly 70% of sales are for repair and renovations, which have remained stable in prior economic contractions. AWI remains well positioned as the leader in the market for ceiling tile.

Sector Influence

We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:

- **What Helped:** Underweight Info. Technology & Real Estate (two weaker performing sectors)
- **What Hurt:** Underweight Energy & Healthcare (the best performing sectors)

Trades During the Quarter

- **Received Cash:** **Alleghany (Y)** – Berkshire Hathaway completed acquisition of Y in an all cash deal.
- **Increased:** **Armstrong World Industries (AWI)**, **Ball Corp (BLL)**, **Moelis (MC)** & **UniFirst (UNF)** – Used excess cash to increase position size in four existing holdings. We have owned each company for years and maintain a positive outlook for the shares.
- **Initiated:** **Pool Corp. (POOL)** – POOL is the largest global distributor of pool related products. Within the pool industry value chain, 70% of the products are sold through distributors (Suppliers > Distributors > Customers). Each layer of the value chain is very fragmented except for POOL, which has a commanding 37% market share. POOL's size and scale give it bargaining power over the upstream and downstream, allowing it to capture outsized profits from the value chain. Scale advantages also lead to superior margins, and it has translated to a superior value position, which allows POOL to consistently win share. Roughly 40% of its business mix comes from new construction and remodeling, but 60% of revenues come from stable, recurring, non-discretionary pool maintenance. POOL has mid-teens EBIT margins (excellent for a distributor), strong returns on capital and limited debt. The stock sold off 40% due to concerns around the macro environment, but we believe they're well positioned in a defensible industry that has solid long-term tailwinds. Over the full cycle, we believe POOL will be a solid compounder, and the negative sentiment presented a good entry point.

Looking Ahead

As we enter 2023, conditions remain fragile, and the lagged effect of 2022's rate hikes and Quantitative Tightening (QT) may lead to further economic weakness. Inflation remains higher than desired, but inflation readings have improved from peak levels. Meanwhile, the labor market remains tight and the service side of our economy remains strong. As the Fed continues to balance its goals of stable pricing and full employment, additional rate hikes are likely early in the year. It is hard to predict what could happen longer term, but the message from the Fed is that rates will stay higher for longer. Much will depend on the level of inflation and the performance of the broader economy. In terms of the equity market, we recognize the difficulty in determining what is already factored into stock prices at this point in the economic cycle. With higher interest rates likely, equity valuations may experience multiple compression, while a slowing economy may lead to weaker earnings from many companies. The next phase of this slowdown will likely hinge on the path of earnings, credit spreads, and employment. In this more challenging environment, we continue to expect greater volatility in share prices and lower expected returns relative to the strong returns generated from 2009-2021. Longer term, we continue to believe that quality attributes and solid company fundamentals will lead to strong risk-adjusted returns.

Looking ahead, we believe the strong cash flow generation and capital flexibility of our businesses should provide meaningful protection if market fundamentals continue to deteriorate.

Annualized Returns As of 12/31/2022

	QTD	1Y	3Y	5Y	10Y	ITD
Mid Cap (Gross)	6.2%	-14.9%	3.7%	8.4%	11.7%	11.7%
Mid Cap (Net)	6.1%	-15.1%	3.4%	8.0%	11.3%	11.2%
Russell MidCap	9.2%	-17.3%	5.9%	7.1%	11.0%	10.5%

Disclosure Notes

The London Company's performances are size weighted and annualized based on calculations for the period ending 12/31/2022. The characteristics discussed herein relate to a representative account, and not every client's account will have these exact characteristics. As London manages its client portfolios according to each client's specific investment needs and circumstances, London cannot affirm that the characteristics of the account shown are similar to all accounts participating in the strategy. This is due in part to the timing of trades by the Advisor, market conditions, cash availability, and the timing of client deposits and withdrawals. Therefore, prospective clients should not assume that similar performance results to those shown would have been achieved for their accounts had they been invested in the strategy during the period. None of the information contained herein should be construed as an offer to buy or sell securities, or as investment recommendations. An investment in a London Company strategy is subject to risks, including the loss of principal.

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Composite Creation/Inception Date: March 31, 2012

Composite Definition: The Mid Cap equity strategy invests mainly in conservative, low-beta, mid-cap equities with a focus on above-average downside protection. Primarily, we seek profitable, financially stable mid-cap companies that consistently generate free cash flow, high returns on unleveraged operating capital, trade at significant discounts to their intrinsic values, and are run by shareholder-oriented management. Positions are usually within the market capitalization range of the major, domestic mid-cap indices. Accounts in this product composite are fully discretionary taxable and tax-exempt portfolios with a minimum of \$100,000 in assets. This product is measured against the Russell Mid Cap Index and has a creation and inception date of March 31, 2012. There is no use of leverage, derivatives, or short positions. All actual fee-paying discretionary portfolios are included in one or more composites that have been managed for a full calendar quarter with limited restrictions and similar objectives.

Benchmark Description: Primary: Russell Mid Cap Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Mid Cap is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. Secondary: Russell Mid Cap Value Index measures the performance of the mid-cap segment of the U.S. equity universe. It includes those Russell Mid Cap Index companies with lower price-to-book ratios and lower forecasted growth values. Benchmark returns are not covered by the report of independent verifiers.

Performance and Fees: Gross of fee returns are calculated gross of management and custodian fees and net of transaction costs. Net of fee returns are calculated net of actual management fees and transaction costs and gross of custodian and other fees. Returns may be net of miscellaneous fund expenses. The gross figures do not reflect the deduction of investment advisory fees. Returns are calculated and stated in U.S. dollars. Returns are calculated gross of withholding taxes on foreign dividends and interest. Dividends are reinvested. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

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